CHINA & SOUTH SEA BANK LTD.

v.

TAN SOON GIN, GEORGE

COURT OF APPEAL, HONG KONG
LORD KEITH OF KINKEL
LORD TEMPLEMAN
LORD ACKNER
LORD OLIVER OF AYLMERTON
LORD GOFF OF CHIEVELEY
[PRIVY COUNCIL APPEAL NO. 55 OF 1988]
13 NOVEMBER 1989

BANKING: *Guarantee - Payment of principal sum and interest thereon secured by guarantee and mortgage of shares - Creditor demanding from surety payment of principal and interest - Amount claimed not disputed - Surety claims creditor owed a duty of care in exercising power of sale of mortgaged shares - Shares claimed to be valuable when debt became due and owing - Shares admittedly worthless when demand was made on surety - Whether surety should be given conditional leave to defend.*

TORT: *Duty of care of creditor to surety - Exercise of power of sale conferred by mortgage.*

By a deed of guarantee dated 18 May 1982, the surety (George Tan) guaranteed the repayment of the principal sum of HK$30,000 plus interest thereon to the creditor (The China and South Sea Bank Ltd.) advanced to the debtor (Carrian Holdings Ltd.). On 19 May 1982 Filomena Ltd. mortgaged shares in Carrian Investments Ltd. to secure the said advance to the debtors. The mortgage contained the usual power of sale. By a deed of variation, dated 18 August 1982, it was agreed by and between Filomena Ltd., the surety, the debtor and the creditor that the principal sum and interest payable by the debtor, guaranteed by the surety and secured by the mortgage should become payable on 18 November 1982. By letter dated 31 October 1983, the creditor demanded from the surety the principal sum and interest thereon. The surety agreed that the monies claimed by the creditor are due in accordance with the express terms of the guarantee. However, the surety, claimed that he was discharged from any liability to pay under the guarantee because the creditor owed the surety a duty to exercise the powers of sale conferred by the mortgage. The surety claimed that the shares were worth HK$60,000 on 19 May 1982 (date of mortgage) and not less than HK$30,000 on 18 November 1982 (when the principal sum became due). The shares had admittedly become worthless when the demand was made on the surety. The surety claimed that the creditor knew or ought to have known of the declining value of the shares and should have sold them before they became worthless. Summary judgment under O. 14 was allowed by the master and upheld by the Judge but reversed by the Hong Kong Court of Appeal which allowed the surety conditional leave to defend.

Held:

[1] The tort of negligence has not yet subsumed all torts and does not supplant the principles of equity or contradict contractual promises or complement the remedy of judicial review or supplemental statutory rights.

[2] Equity intervenes to protect a surety and if through any neglect on the part of the creditor, a security to the benefit of which a surety is entitled is lost, or is not properly perfected, the surety is discharged. In the present case, the security was neither surrendered nor lost nor imperfect nor altered in condition by reason of what was done by the creditor.

[3] The surety contracts to pay if the debtors do not pay and the surety is bound by his contract.

[4] In the present case, the creditor did not act injurious to the surety, did not act inconsistent with the rights of the surety and the creditors, did not omit any act which his duty enjoined him to do. The creditor was not under a duty to exercise his power of sale over the mortgaged securities at any particular time or at all.

[Advise to Her Majesty: *Appeal allowed, order of Court of Appeal set aside, order made by Rhind J to be restored. Respondent to pay appellant's costs in the Court of Appeal and Privy Council.]*

Cases referred to:
Watts v. Shuttleworth [1860] 5 H & N 235
Wulff v. Jay [1872] LR 7 QB 756

JUDGMENT

Lord Templeman:

In May 1982 the appellant creditor, China and South Sea Bank Limited, ("the creditor") advanced HK$30,000,000 to the debtor, Carrian Holdings Limited. By deed of guarantee dated 18 May 1982 the respondent surety, George Tan, ("the surety") undertook to repay the principal sum advanced to the debtor and the monthly interest thereon. By the terms of the guarantee, the surety agreed with the creditor *inter alia* that:

This guarantee shall be without prejudice to and shall not be affected nor shall I be exonerated by any of the matters following:

1. Any securities negotiable or otherwise which you may now or hereafter hold from the principal or any other persons in respect of any money hereby guaranteed.
2. Any arrangement made by you at your discretion for the variation exchange renewal release modification refusal to complete or enforce assign any judgments specialities or other securities or instruments negotiable or otherwise whether satisfied by payment or not.
3. Any determination enlargement or variation of any credit to the principal or any time given or extended to the principal or any other persons (including drawers acceptors or indorsers of negotiable or other instruments or securities) or other indulgence granted or composition compromise or arrangement made with the principal or any other persons whether with or without my consent or notice to me.

By a mortgage dated 19 May 1982 and a deposit of securities, Filomena Limited mortgaged shares in Carrian Investments Limited to secure the principal sum and interest advanced by the creditor to the debtor. The mortgage contained the usual power of sale.

By deed of variation dated 18 August 1982 it was agreed by and between Filomena Limited, the surety, the debtor, and the creditor that the principal sum and interest payable by the debtor, guaranteed by the surety and secured by the mortgage should become payable on 18 November 1982. By a letter dated 31 October 1983 the creditor demanded from the surety payment of the principal sum of HK$30,000,000 and interest of HK$3,496,438.34 accrued at 28 October 1983 and unpaid and any interest arising after 28 October 1983.

By a writ and endorsed statement of claim dated 9 November 1983 and an O. 14 summons dated 9 April 1984 the creditor sought summary judgment against the surety for the principal and interest secured by the guarantee. Master Hansen gave judgment in favour of the creditor and his decision was upheld by Rhind J but reversed by an order of the Court of Appeal of Hong Kong (Cons V.-P. and Barker and Power JJA) granting the surety unconditional leave to defend. The creditor now appeals with leave to the board.

The surety claims that he is not liable to pay anything to the creditor by reason of the following allegations which he offers to prove at trial:

(1) The shares mortgaged by Filomena were worth HK$60,000,000 on 19 May 1982, the date of the mortgage.

(2) The shares were worth not less than HK$30,000,000 on 18 November 1982 when the principal sum became due.

(3) The shares had admittedly become worthless.

(4) The creditor knew or ought to have known of the declining value of the shares and should have sold them before they became worthless.

The surety does not and cannot impugn the validity of the provisions of the guarantee and admits that the monies claimed by the creditor are due in accordance with the express terms of the guarantee. But the surety claims that the creditor owed the surety a duty to exercise the power of sale conferred by the mortgage and in that case the liability of the surety under the guarantee would either have been eliminated or very much reduced. The Court of Appeal sought to find such a duty in the tort of negligence but the tort of negligence has not yet subsumed all torts and does not supplant the principles of equity or contradict contractual promises or complement the remedy of judicial review or supplement statutory rights.

Equity intervenes to protect a surety. In *Watts v. Shuttleworth* [1860] 5 H & N 235 the creditor had covenanted to insure mortgaged goods and failed to insure. A surety was released. Pollock C.B. said at p. 247/248:

> The substantial question in the case is, whether the omission to insure discharges the defendant, the surety. The rule upon the subject seems to be that if the person guaranteed does any act injurious to the surety, or inconsistent with his rights, or if he omits to do any act which his duty enjoins him to do, and the omission proves injurious to the surety, the latter will be discharged ... the rights of a surety depend rather on principles of equity than upon the actual contract;

In *Wulff v. Jay* [1872] LR 7 QB 756 the creditor failed to register a mortgage as a bill of sale and failed to take possession of the mortgaged chattels which were then seized by the trustee in bankruptcy of the mortgagor. A surety for the debt owed by the bankrupt to the creditor and secured by the mortgage was discharged to the value of the mortgaged chattels. Cockburn CJ said at p. 762/763:

> Cases have been cited and authorities have been referred to in *Story's Equity Jurisprudence*, which abundantly establish that which is a common and well-known proposition, that where a debt is secured by a surety, it is the business of the creditor, where he has security available for the payment and satisfaction of the debt, to do whatever is necessary to make that security properly available. He is bound, if the surety voluntarily proposes to pay the debt, to make over to the surety what securities he holds in respect of that debt, so that, being satisfied himself, he shall enable the surety to realise the securities and recoup himself the amount of the debt which he has had to pay. That is now a well-known proposition. Here, by registering

> the bill of sale, and by afterwards availing themselves of the power which they possessed to take possession, the plaintiffs might have secured the payment of the debt to themselves, or by protecting the securities and holding them in their hands they could have made them over to the surety when the surety was willing, or was called on, to pay; but by omitting to do what was necessary in order to place themselves in that position, and by allowing bankruptcy to supervene so as to enable the trustee under the bankruptcy to take possession of these goods adversely, it is clear that they have placed the surety in a position very detrimental and prejudicial to the surety; and for that the surety ought to have, according to the general doctrine, a remedy.

Hannen J at p. 764 approved the following rule:

> As a surety, on payment of the debt, is entitled to all the securities of the creditor, whether he is aware of their existence or not, even though they were given after the contract of suretyship, if the creditor who has had, or ought to have had, them in his full possession or power, loses them or permits them to get into the possession of the debtor or does not make them effectual by giving proper notice, the surety to the extent of such security will be discharged. A surety, moreover, will be released if the creditor, by reason of what he has done, cannot, on payment by the surety, give him the securities in exactly the same condition as they formerly stood in his hands.

Quain J at p. 765 approved the rule that:

> ... if through any neglect on the part of the creditor, a security to the benefit of which a surety is entitled is lost, or is not properly perfected, the surety is discharged.

In the present case the security was neither surrendered nor lost nor imperfect nor altered in condition by reason of what was done by the creditor. The creditor had three sources of repayment. The creditor could sue the debtor, sell the mortgaged securities or sue the surety. All these remedies could be exercised at any time or times simultaneously or contemporaneously or successively or not at all. If the creditor chose to sue the surety and not pursue any other remedy, the creditor on being paid in full was bound to assign the mortgaged securities to the surety. If the creditor chose to exercise his power of sale over the mortgaged security he must sell for the current market value but the creditor must decide in his own interest if and when he should sell. The creditor does not become a trustee of the mortgaged securities and the power of sale for the surety unless and until the creditor is paid in full and the surety, having paid the whole of the debt is entitled to a transfer of the mortgaged securities to procure recovery of the whole or part of the sum he has paid to the creditor.

The creditor is not obliged to do anything. If the creditor does nothing and the debtor declines into bankruptcy the mortgaged securities become valueless and the surety decamps abroad, the creditor loses his money. If disaster strikes the debtor and the mortgaged securities but the surety remains capable of repaying the debt then the creditor loses nothing. The surety contracts to pay if the debtor does not pay and the surety is bound by his contract. If the surety, perhaps less indolent or less well protected than the creditor, is worried that the creditor, is worried that the mortgaged securities may decline in value then the surety may request the creditor to sell and if the creditor remains idle then the surety may bustle about, pay off the debt, take over the benefit of the securities and sell them. No creditor could carry on the business of lending if he could become liable to a mortgager and to a surety or to either of them for a decline in value of mortgaged property, unless the creditor was personally responsible for the decline. Applying the rule as specified by Pollock C.B. in *Watts v. Shuttleworth* (*supra*) at p. 247, it appears to their Lordships that in the present case

the creditor did no act injurious to the surety, did no act inconsistent with the rights of the surety and the creditor did not omit any act which his duty enjoined him to do. The creditor was not under a duty to exercise his power of sale over the mortgaged securities at any particular time or at all.

Their Lordships will humbly advise Her Majesty that this appeal should be allowed, the order of the Court of Appeal set aside and the order made by Rhind J restored. The respondent must pay the appellant's costs in the Court of Appeal and before their Lordships' Board.

Also found at [1990] 1 CLJ 665